SECURITIES—INSIDER TRADING—THE EFFECTS OF THE NEW EEC DRAFT INSIDER TRADING DIRECTIVE

INTRODUCTION

If asked to classify the practice of insider trading in securities as either moral or immoral, the majority of the American public would not hesitate to classify this practice as immoral. The United States government's long-standing prohibition and punishment of insider trading reflects but one manifestation of this view.[1] This view of insider trading is not, however, held worldwide. Within Europe, and particularly within the European Economic Community (EEC), there exist some states which consider insider trading immoral[2] and others which consider insider trading perfectly acceptable.[3] This disparity, when combined with the varying levels of regulation within the EEC, poses a problematic situation. It fosters varying degrees of investor protection among member-States, which hinders interpenetration[4] of national markets, and in turn inhibits freedom of movement of capital among member-States, thus precluding the formation of a true common capital market.[5]

Recognizing the problems caused by the varying approaches to insider trading employed by member-States, the European Commis-

---

[1] *See* Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1982); Securities Exchange Act of 1934, § 16(b), 15 U.S.C. § 78p(b) (1982); Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987); Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90 (10th Cir. 1971), *cert. denied*, 404 U.S. 1004 (1971); In re Cady, Roberts & Co., 40 S.E.C. 907 (1961).

[2] For example, France and the United Kingdom both prohibit insider trading. *See, e.g.*, Wallace, *Who Is Subject to the Prohibition Against Insider Trading: A Comparative Study of American, British and French Law*, 15 SW. U.L. REV. 217, 225-40 (1985).

[3] Greece, Italy, and Portugal, for example, consider insider trading to be acceptable. *See, e.g.*, B. RIDER & H. FFRENCH, THE REGULATION OF INSIDER TRADING 251-53, 263 (1979).

[4] Interpenetration is the penetration by investors of national stock exchange markets in states other than their own for the purpose of trading. *See Press Release from the Commission of the European Communities*, 4 Common Mkt. Rep. (CCH) ¶ 10,880 (Apr. 28, 1987).

[5] *Id.* A true common capital market exists where there is only one capital market servicing the EEC, or more realistically, several capital markets, which because of their uniformity and freedom from barriers function as one capital market. *See* II.A. INTERNATIONAL ORGANIZATION AND INTEGRATION at Dir. 6-8 (1982) [hereinafter INT'L ORG.].

sion adopted and submitted to the European Council a draft directive prohibiting insider trading.[6] The drafters of the directive intended it to harmonize the laws of the member-States with regard to insider trading and to provide a minimum level of investor protection throughout the Community.[7] The proposed directive takes a significant step toward the realization of a true common capital market, but because it does not attempt to harmonize the penalties for violating insider trading rules,[8] the directive falls short of what is ultimately needed in this area.

A. Definition of Insider Trading

Despite the apparent lack of controversy surrounding the definition of insider trading, its definition provides stepping stones to other points of controversy.[9] One commentator defines insider trading as "the deliberate exploitation of unpublished price-sensitive information, obtained through a privileged relationship, to make a profit or avoid a loss by dealing in securities the price of which would be materially altered by public disclosure of that information."[10] The Draft Directive itself contains another similar, but more relevant, definition of insider trading. Article 1 of the directive defines insider trading as when "any person who, in the exercise of his profession or duties, acquires inside information . . . [and takes] advantage of that information to buy or sell . . . transferable securities."[11] In the process of defining insider trading, both of these definitions raise other definitional problems such as the breadth of the term "insider" and the scope of the term "inside information" (also "price-sensitive information"). Member-States resolve these questions in various ways, and because of this lack of unity, the Draft Directive purports to harmonize the answers to these questions.[12]

---

[6] *Proposal for a Council Directive Coordinating Regulations on Insider Trading*, 30 O.J. EUR. COMM. (No. C 153) 8 (1987) [hereinafter *Draft Directive*].

[7] *Press Release from the Commission of the European Communities*, 4 Common Mkt. Rep. (CCH) ¶ 10,880 (Apr. 28, 1987).

[8] The Draft Directive imposes no minimum penalties, nor does it recommend any effective penalties. *Draft Directive, supra* note 6.

[9] *See infra* notes 102-37 and accompanying text.

[10] 1 GORE-BROWNE ON COMPANIES § 12.17 (44th ed. 1986) [hereinafter GORE-BROWNE].

[11] *Draft Directive, supra* note 6, at art. 1.

[12] *See Press Release from the Commission of the European Communities*, 4 Common Mkt. Rep. (CCH) ¶ 10,880 (Apr. 28, 1987). How the Draft Directive harmonizes these points of dispute will be examined later, but for now it is sufficient to have a definitional framework via the previous definitions for examining insider trading in the EEC and the Draft Directive.

B. Insider Trading Law of EEC Members

As previously noted, national regulation of insider trading by EEC members[13] varies from member to member. Currently, three members prohibit insider trading through legislation,[14] three members plan to propose such legislation,[15] and one member regulates insider trading through a set of voluntary rules.[16] Other members, however, have neither enacted nor proposed any legislation or rules regulating insider trading.[17] Clearly, if the EEC adopts the Draft Directive prohibiting insider trading, this latter category of members must enact legislation which at least equals the Draft Directive's standard of prohibition.[18] Less clear, however, is how adoption of the Draft Directive would affect those members already regulating, or planning to regulate, insider trading. This lack of clarity arises from the existence of varying techniques and standards in the regulation of insider trading among member-States. Any examination of the Draft Directive and its implementation by member-States must focus, therefore, on how it affects those member-States which currently regulate, or plan to regulate insider trading. This note undertakes such an examination by focusing on the Draft Directive and its effect on two divergent systems of regulation within the Community: the United Kingdom, which employs an extensive statutory system,[19] and West Germany, which operates under a voluntary system.[20]

---

[13] Currently, 12 member-States constitute the EEC: Belgium, France, West Germany, the Netherlands, Italy, Luxembourg, the United Kingdom, Ireland, Denmark, Greece, Spain, and Portugal. *Common Market in Profile*, 1 Common Mkt. Rep. (CCH) ¶ 101.07 (June 18, 1987).

[14] These members are the United Kingdom, France, and Denmark.

[15] Ireland, Belgium, and the Netherlands.

[16] West Germany.

[17] *Press Release from the Commission of the European Communities*, 4 Common Mkt. Rep. (CCH) ¶ 10,880 (Apr. 28, 1987).

[18] The Draft Directive imposes only a minimum standard for prohibiting insider trading. Member-States may enact more stringent legislation than the prohibition in the Draft Directive if they choose, but they cannot enact legislation less stringent. *Draft Directive, supra* note 6, at art. 4.

[19] The United Kingdom, along with France, have the most developed statutory system for the regulation of insider trading within the EEC. *See*, Note, *Insider Trading and the EEC: Harmonization of the Insider Trading Laws of the Member States*, 8 B.C. INT'L & COMP. L. REV. 151 (1985).

[20] West Germany, while it has chosen to regulate insider trading, has done so via a voluntary regulatory system. This method of regulation represents the least amount of regulating among those member-States choosing to regulate insider trading. B. RIDER & H. FFRENCH, *supra* note 3, at 243-47.

1. United Kingdom

Insider trading is not unfamiliar in the United Kingdom,[21] but Parliament only in 1980 introduced statutory regulation as a means of dealing with this problem.[22] Until the advent of statutory regulation, the United Kingdom employed other methods for controlling insider trading. These methods, historically proven inadequate, fall into three general categories: common law,[23] self regulation,[24] and disclosure.[25]

The common law position on insider trading is rooted in the 1902 case of *Percival v. Wright*.[26] In *Percival*, shareholders offered to sell their stock to the corporation's directors. Consummation of the sale, however, occurred as the directors negotiated a sale of the corporation to a third party. The directors did not disclose this information, which would have substantially increased the price of the shareholders' stock, prior to their sale with the shareholders. The former shareholders, learning of the negotiations subsequent to the sale of their shares to the directors, brought an action in equity against the directors. The shareholders claimed the directors were in a fiduciary relationship with shareholders of the corporation and therefore under a duty to disclose the price-sensitive information. The Chancery Court held that while corporate directors have a fiduciary relationship with the corporate entity, they do not have such a relationship with individual shareholders; shareholders, therefore, have no individual claim against corporate directors for insider trading.[27]

While *Percival* closed the door to shareholders, it did recognize a fiduciary relationship between the directors and the corporation.[28]

---

[21] For a complete discussion of insider trading in the United Kingdom, *see* B. RIDER & H. FFRENCH, *supra* note 3, at 146-231; GORE-BROWNE, *supra* note 10, at § 12.17-.32; D. KEENAN, SMITH AND KEENAN'S COMPANY LAW 395-98 (6th ed. 1986); Wallace, *supra* note 2, at 233-40; R. PENNINGTON, COMPANY LAW 431-34 (5th ed. 1985); Note, *supra* note 19, at 169-70.

[22] *See* Companies Act, 1980, ch. 22, §§ 68-73. The codification of the current statutory regulations occurred in 1985. *See* Company Securities (Insider Dealing) Act, 1985, ch. 8.

[23] For a discussion of the common law method see B. RIDER & H. FFRENCH, *supra* note 3 at 146-60; Wallace, *supra* note 2, at 233-34; GORE-BROWNE, *supra* note 10, at § 12.21.

[24] For a discussion of the self-regulation method see B. RIDER & H. FFRENCH, *supra* note 3, at 160-74; Wallace, *supra* note 2, at 234-36.

[25] For a discussion of the disclosure method see B. RIDER & H. FFRENCH, *supra* note 3, at 174-84; Wallace, *supra* note 2, at 234-35.

[26] 2 Ch. 421 (1902).

[27] *Id.* at 425-26.

[28] *Id.* at 425.

This left the door open for the corporation to sue the directors, but few corporations have done so because of a general reluctance to sue one's own directors.[29] Individuals looking for protection themselves from insider trading advanced alternative theories for holding insiders liable to individual shareholders, including the law of confidence,[30] the duty to disclose,[31] and unjust enrichment.[32] The courts' narrow application of these theories to the area of insider trading, however, fails to provide an adequate remedy for the harm suffered by individual shareolders.

The second method by which the United Kingdom addresses the problem of insider trading is through the self-regulation of the private sector. The practice of self-regulation arose primarily from the fear that the government would begin regulating insider trading if the professional world continued to do nothing to abate the practice.[33] Two professional institutions, the City Panel on Takeovers and Mergers[34] and the Council for the Securities Industry,[35] represent the

---

[29] Wallace, *supra* note 2, at 234. More often than not the insider is the controller of the corporation or a director, and his colleagues are reluctant to sue. B. RIDER & H. FFRENCH, *supra* note 3, at 155.

[30] This doctrine covers the employer-employee relationship by requiring the employee not to misuse confidential information entrusted to him in a manner imparting an obligation to keep the information confidential. Application of this doctrine "generally involve[s] trade secrets and intellectual property," but courts have applied it to "revised earnings forecasts and plans for changes in corporate capital structure." B. RIDER & H. FFRENCH, *supra* note 3, at 158 (citing Coco v. A.N. Clark (Engineers) Ltd., (1969) R.P.C. 41; Dunford & Elliot Ltd. v. Johnson & Firth Brown Ltd., (1977) 1 Lloyd's Rep. 505).

[31] Traditionally, in the absense of any misrepresentation the failure to disclose material information in a contractual situation does not give rise to any liability. Courts have found that some contracts, for example insurance contracts, carry a duty not to conceal information, and some scholars argue that the same duty should be applied to securities contracts. There exists, however, scant support for this proposition. *Id.* (citing Carter v. Boehm, (1766) 3 Burr. 1905).

[32] Application of the doctrine of unjust enrichment requires an enrichment of the defendant's position, a corresponding detriment to the plaintiff, and a resulting unjustness if the parties are not restored to their prior positions. While all three requirements are met in an insider trading case, courts have been reluctant to invalidate the transaction absent any legal wrong, e.g., "misrepresentation, fraud, duress or mistake". *Id.* at 160 (citing Coleman v. Myers, (Supreme Court of New Zealand, 13 May 1976)).

[33] *Id.*

[34] The City Panel on Take-overs and Mergers was established in the mid 1960's and consists of 9 representatives from the various City institutions. It uses "public and private censure" as sanctions against insiders. B. RIDER & H. FFRENCH, *supra* note 3, at 160-61.

[35] The Council for the Securities Industry was established in 1978 and consists of representatives from various professions and institutions. Wallace, *supra* note 2, at 235.

bulk of the attempts at self-regulation.[36] The Panel attempts to regulate insider trading through a code prohibiting insider trading, adherence to which is optional unless a corporation wishes to obtain a listing on the Stock Exchange.[37] In contrast, the Council's objective is to study and propose recommendations. The Council isolates areas in need of improvement and then generates recommendations for implementing that improvement.[38] Both of these bodies continue their attempts to regulate insider trading despite the advent of statutory regulations. In fact, statutory regulation has recognized and even enhanced the efforts of these institutions.[39] The United Kingdom did not implement statutory regulation because self-regulation failed at regulating insider trading, but rather it implemented a statutory scheme in part to reinforce self-regulation. The government believed that stiffer enforcement and harsher penalties were necessary to back up self-regulation.[40]

The final method used prior to statutory regulation in the United Kingdom is disclosure. Much like self-regulation, this method remains an integral part of regulating insider trading.[41] Disclosure was enacted statutorily[42] and has two significant aspects. First, it requires shareholders with substantial shareholdings to register,[43] and second, it requires directors to disclose their share dealings.[44] The rationale

---

[36] *Id.* at 235-36. Other self-regulatory measures include Stock Exchange disclosure requirements and corporate in-house rules and procedures. B. RIDER & H. FFRENCH, *supra* note 3, at 166-74.

[37] Wallace, *supra* note 2, at 236. The Stock Exchange is the Stock Exchange for the United Kingdom and Ireland formed in 1973. R. PENNINGTON, *supra* note 21, at 252 n.1.

[38] *See* Wallace, *supra* note 2, at 235.

[39] *See id.* at 236.

[40] *Id.*

[41] B. RIDER & H. FFRENCH, *supra* note 3, at 174.

[42] In 1967, Parliament enacted disclosure requirements for corporate directors who held shares in the corporation. Companies Act, 1967, ch. 81, §§ 25, 27-31. For the current disclosure requirements, see Companies Act, 1985, ch. 6, §§ 198-220, 323-29.

[43] Companies Act, 1985, ch. 6, §§ 198-202. This disclosure requirement arises only in the wake of certain stipulated events, or when a shareholder acquires 5% or more of the total nominal value of a class of shares with unrestricted voting rights. *Id.* at §§ 198-201.

[44] Section 324 of the Act provides that:

> (1) A person who becomes a director of a company and at the time when he does so is interested in shares in, or debentures of, the company or any other body corporate, being the company's subsidiary or holding company or a subsidiary of the company's holding company, is under obligation to

underlying these regulations is that public exposure of those individuals trading on inside information will deter the practice of insider trading.[45] This mechanism, as with the previous two, also proved inadequate in the absence of statutory regulation.

The United Kingdom thus implemented statutory regulation of insider trading to provide stiffer penalties and to reinforce those anti-insider-trading mechanisms already in place.[46] Parliament first enacted an insider trading prohibition in the Companies Act 1980[47] and then reenacted it in the Company Securities (Insider Dealing) Act 1985.[48] The 1985 Act, as well as the 1980 Act, make the practice of insider trading a criminal offense, with no provision for civil liability.[49] Furthermore, the 1985 Act only applies to transactions carried out on a recognized stock exchange;[50] consequently, private transactions like the one in *Percival* remain unaffected.[51]

The embodiment of the 1985 Act's general prohibition of insider trading rests in Section 1(1).[52] This provision prohibits only primary

---

notify the company in writing —

(a) of the subsistence of his interests at that time; and

(b) of the number of shares of each class of, and the amount of debentures of each class of, the company or other such body corporate in which each interest of his subsists at that time.

Companies Act, 1985, ch. 6, § 324(1); *see also id.* at §§ 323-29. For the original enactment, see Companies Act, 1967, ch. 81, §§ 25, 27-31.

[45] Wallace, *supra* note 2, at 234.

[46] *See supra* note 40 and accompanying text.

[47] Companies Act, 1980, ch. 22, §§ 68-73.

[48] Company Securities (Insider Dealing) Act, 1985, ch. 8.

[49] *Id.* at § 8; Companies Act, 1980, ch. 22, § 72; GORE-BROWNE, *supra* note 10, at § 12.22, 32.

[50] Company Securities (Insider Dealing) Act, 1985, ch. 8, § 1 (limited to transactions on a "recognized stock exchange"); *see also* GORE-BROWNE, *supra* note 10, at § 12.22.

[51] *See* GORE-BROWNE, *supra* note 10, at § 12.22.

[52] Company Securities (Insider Dealing) Act, 1985, ch. 8, § 1(1). The Act provides:

(1) Subject to section 3, an individual who is or at any time in the preceding 6 months has been, knowingly connected with a company shall not deal on a recognised stock exchange in securities of that company if he has information which—

(a) he holds by virtue of being connected with the company,

(b) it would be reasonable to expect a person so connected, and in the position by virtue of which he is so connected, not to disclose except for the proper performance of the functions attaching to that position, and

(c) he knows is unpublished price-sensitive information in relation to those securities.

Id. Section 3 of the 1985 Act lists possible defenses to the general prohibition on insider trading. *See infra* notes 61 and 62 and accompanying text.

insider trading, where the individual obtaining the inside information and the individual trading on that information are the same. The 1985 Act also prohibits secondary insider trading,[53] where an individual trades on inside information received from another individual. A third type of insider trading prohibited by the 1985 Act involves an individual connected with one corporation trading in the securities of another corporation. The prohibited trade is based on information relating to an actual or contemplated transaction between the two corporations.[54] This final insider trading closely resembles primary insider trading but differs in that two corporations are involved and the insider trades in the other corporation's stock.

Because violations of the 1985 Act are criminal offenses, the statute contains a mens rea requirement.[55] Conviction under the 1985 Act requires the supposed insider to have had a profit motive when he traded on the inside information.[56] In addition, the statute imposes another subjective requirement: the supposed insider (either primary or secondary) must be cognizant that the primary individual is connected with one of the companies involved, and that he (the supposed insider) possesses inside information.[57]

The 1985 Act defines inside information in Section 10, which states that there are two characteristics of "unpublished price-sensitive information."[58] First, the information must relate to a specific matter of the corporation rather than relating to the corporation in a general nature.[59] Second, the information must not be generally known by those persons who regularly or could potentially deal in that cor-

---

[53] *Id.* at §§ 1(3) and (4). Secondary insider trading is also known as "tippee" insider trading.

[54] *Id.* at § 1(2). Public servants who obtain information in their official capacity are also defined as insiders. *Id.* at § 2.

[55] This can be inferred from § 3 providing the defense of lack of a profit motive. *Id.* at § 3. *See also* Wallace, *supra* note 2, at 236-37.

[56] *See* Wallace, *supra* note 2, at 236-37.

[57] Company Securities (Insider Dealing) Act, 1985, ch. 8, §§ 1(1) and (3).

[58] *Id.* at § 10. Section 10 provides in full:

> Any reference in this Act to unpublished price-sensitive information in relation to any securities of a company is a reference to information which —
>
> (a) relates to specific matters relating or of concern (directly or indirectly) to that company, that is to say, is not of a general nature relating or of concern to that company, and
>
> (b) is not generally known to those persons who are accustomed or would be likely to deal in those securities but which would if it were generally known to them be likely materially to affect the price of those securities.

[59] *Id.* at § 10(a).

poration's securities, and if known, it must be of such nature that it would "materially" affect the securities' price.[60]

The 1985 Act also provides for several defenses to the charge of insider trading.[61] These defenses include lack of a profit motive, an exercise of good faith by a liquidator, receiver (or trustee) in bankruptcy, and the obtainment and good faith use of information by a jobber.[62] An individual convicted of insider trading under the 1985 Act faces imprisonment of up to two years, a fine, or both.[63]

2. *West Germany*

The regulation of insider trading in West Germany is most appropriately labelled "voluntary self-regulation."[64] Unlike the United

---

[60] *Id.* at § 10(b).

[61] *Id.* at § 3. Section 3 provides in full that:

(1) Sections 1 and 2 do not prohibit an individual by reason of his having any information from —

(a) doing any particular thing otherwise than with a view to the making of a profit or the avoidance of a loss (whether for himself or another person) by the use of that information;

(b) entering into a transaction in the course of the exercise in good faith of his functions as liquidator, receiver or trustee in bankruptcy; or

(c) doing any particular thing if the information —

(i) was obtained by him in the course of a business of a jobber in which he was engaged or employed, and

(ii) was of a description which it would be reasonable to expect him to obtain in the ordinary course of that business, and he does that thing in good faith in the course of that business.

"Jobber" means an individual, partnership or company dealing in securities on a recognised stock exchange and recognised by the Council of the Stock Exchange as carrying on the business of a jobber.

(2) An individual is not, by reason only of his having information relating to any particular transaction, prohibited —

(a) by section 1(2), (4)(b), (5) or (6) from dealing on a recognised stock exchange in any securities, or

(b) by section 1(7) or (8) from doing any other thing in relation to securities which he is prohibited from dealing in by any of the provisions mentioned in paragraph (a), or

(c) by section 2 from doing anything, if he does that thing in order to faciliatate the completion or carrying out of the transaction.

Id.

[62] *Id.* A "jobber" is "an individual, partnership or company dealing in securities on a recognized stock exchange and recognized by the Council of the Stock Exchange as carrying on the business of a jobber." *Id.* at § 3(1)(c)(ii).

[63] *Id.* at § 8.

[64] *See supra* notes 16 and 20.

Kingdom's statutory regulations, West Germany developed a voluntary set of anti-insider-trading guidelines.[65] Adherence to this set of guidelines is not mandatory, but once an individual or corporation agrees to adhere to them, the parties involved monitor and enforce compliance[66] of the guidelines via a contract between them.[67] The need for guidelines concerning insider trading in West Germany arose because of the silence on the part of civil law and an inadequate alternative cause of action at common law to remedy the problem.[68] The Commission of Stock Exchange Experts,[69] recognizing a need for some form of investor protection, undertook to draft a voluntary set of guidelines for dealing with insider trading. These guidelines, currently embodied in the Insider Trading Guidelines of July 1, 1976 ("Guidelines"),[70] prohibit insider trading, but as previously stated they are applicable only when a corporation agrees to follow them; even then, the corporation may cease following them at any time.[71]

The Guidelines are similar to the United Kingdom's 1985 Act in that they initially establish a general prohibition of insider trading.[72] The definition of an "insider" under the Guidelines, however, is less inclusive than under the United Kingdom's 1985 Act.[73] Under the Guidelines, insiders include the board of directors and legal representatives of a corporation and its subsidiaries, domestic shareholders holding more than 25% of a corporation's stock, or other employees of a corporation in a position tending to receive inside information and in some situations bank and credit institutions.[74]

---

[65] *Insider Rules* (*Insider-Regeln*), published by the Frankfurt Stock Exchange 1985 [hereinafter *Insider Rules*].

[66] Blum, *The Regulation of Insider Trading in Germany: Who's Afraid of Self-Restraint?*, 7 NW. J. INT'L L. & BUS. 507, 519 (1986). Compliance is not monitored by an independent entity but rather by the parties involved, although one of the parties may ask the Board of Inquiry to investigate suspected violations. *Id.* at 520.

[67] *Insider Rules, supra* note 65, at § 4 n.1; *see also* Blum, *supra* note 66, at 519.

[68] Blum, *supra* note 66, at 515.

[69] In 1968, the Federal Minister of Economics established this commission to draft and enact changes in the West German stock exchange system. *Id.*

[70] *Insider Rules, supra* note 65. The guidelines amended an earlier document adopted by the Commission of Stock Exchange Experts and the Minister of Economics in 1970. This document was entitled "Recommendations for the Solution of the So-Called Insider Problems." Blum, *supra* note 66, at 516.

[71] Blum, *supra* note 66, at 519.

[72] *Insider Rules, supra* note 65, at § 1.1; Blum, *supra* note 66, at 517; Elsing & Gasser, *Stock Exchange Rules in Germany and the Treatment of Insider Trading*, 14 INT'L BUS. LAW. 191 (June 1986).

[73] *See supra* notes 52-54 and accompanying text.

[74] Not included in this definition are secondary insiders or tippees. *Insider Rules, supra* note 65, at § 2.1(a)-(d); Blum, *supra* note 66, at 518; Elsing & Gasser, *supra* note 72, at 191.

Despite the somewhat limited definition of insiders, the Guidelines define "inside information" rather broadly as "knowledge about known and unknown circumstances which can influence the valuation of insider securities."[75] The Guidelines then proceed to enumerate examples of inside information.[76] In determining what constitutes inside information according to the Guidelines, the key is not the confidentiality of the information, but rather the availability of the information to the public at the time the insider trades upon that information.[77]

Unlike the 1985 Act, the Guidelines impose no criminal sanction for violations.[78] Instead, the Guidelines impose a remedy via the law of contracts.[79] When a corporation decides to abide by the Guidelines, that corporation contracts with its "potential" insiders (usually through an employment contract) to adhere to the Guidelines. If an insider then breaks the contract with the corporation by trading on inside information, the corporation may bring an action for breach of contract. The corporation's remedy for breach amounts to the recovery of all profits made by the insider. In addition to this disgorgement remedy, the courts may also enforce the contract, and the insider must bear the cost of the proceedings if he has truly breached the contract.[80]

C. The Directive Process

One of the main tools the EEC utilizes in its decision-making process is the directive, and understanding the directive process proves

---

[75] *Insider Rules, supra* note 65, at § 3 (as translated by Blum, *supra* note 66, at 518).

[76] *Insider Rules, supra* note 65, at § 3(a)-(e) (as translated by Blum, *supra* note 66, at 518). The examples include:

(a) changes in dividend rates;
(b) substantial changes in earnings or facts which may influence such earnings;
(c) actions taken to reduce or raise capital, including the raising of capital from corporate resources;
(d) conclusion of a direct-control contract or profit-sharing agreement;
(e) takeover and settlement offers;
(f) planned mergers, amalgamations, transfers of assets, and reorganizations; and
(g) dissolution of the company.

Id.

[77] Blum, *supra* note 66, at 519; Elsing & Gasser, *supra* note 72, at 192.

[78] This lack of criminality follows from the Guidelines' voluntary nature.

[79] Blum, *supra* note 66, at 519.

[80] *Id.* at 519-20.

essential to analyzing the Draft Directive. The directive functions to harmonize the laws of member-States in a particular area when the EEC decides that complete legislative uniformity would be unnecessary.[81] Once passed, a directive becomes binding only as to the result to be achieved and not in the implementation of that result.[82] This distinction provides member-States with flexibility in formulating their domestic laws as long as they attain the required result.

The path of the directive begins in the EEC Commission,[83] where the Commission organizes a working party to research a particular issue and to make recommendations.[84] The Commission then drafts a text and adopts it as a proposal to the Council.[85] Once the Council[86] receives the Commission's proposal, it then sends it to the European Parliament[87] and to the Economic and Social Committee,[88] where appropriate.[89] After receiving the opinions of these two bodies (if sent to both), the proposal goes to the Committee of Permanent Representatives,[90] where another working party organizes and prepares

---

[81] INT'L ORG., *supra* note 5, at Dir. 23.

[82] *Id.*; Note, *supra* note 19, at 164.

[83] The Commission is composed of fourteen members appointed by the member-States. Appointment is based primarily on individual expertise and independence. Those individuals appointed serve four year terms. The functions of the Commission include initiating legislation, monitoring compliance with the treaties, and various executive functions. INT'L ORG., *supra* note 5, at Dir. 11.

[84] *Id.* at Dir. 20-22; Note, *supra* note 19, at 164.

[85] INT'L ORG., *supra* note 5, at Dir. 20-22; Note, *supra* note 19, at 164-65.

[86] The Council is the representative body of the member-States. Each state appoints a minister or junior minister as representative. This is the EEC's "legislative" body, adopting what may be labelled "Community legislation." The Council is also responsible for the EEC's treaties. INT'L ORG., *supra* note 5, at Dir. 15-16.

[87] The European Parliament is composed of representatives of the people of the member-States. This body differs from the Council in that the Council represents the national governments or parliaments and not necessarily the people. Members of the European Parliament are directly elected by the people. Its function is mainly to give advisory opinions on proposed legislation to the Council. While the Council is not required to follow the European Parliament's opinion, it usually does. INT'L ORG., *supra* note 5, at Dir. 16-19.

[88] The Economic and Social Committee is an advisory committee established by the treaty establishing the European Economic Community. Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11, 79-81.

[89] Only where proposed legislation deals with economic or social concerns of the EEC, as defined in sections 193-98 of the Treaty, does the legislation go to the Economic and Social Committee. *Id.*

[90] The Committee of Permanent Representatives prepares the Council's work and performs certain tasks delegated to it by the Council. INT'L ORG., *supra* note 5, at Dir. 10.

the Council's decision.[91] If the Committee reaches a consensus, the Council generally adopts the proposal with little debate.[92] If, however, the Committee reaches no consensus, the Council's consideration of the proposal involves prolonged debate and frequent concessions because of the political nature of the problems which arise.[93] Eventually, the Council reaches a decision, and more often than not it adopts the proposal as a Council Directive.[94]

D. History of the Draft Insider Trading Directive

While concern over insider trading is not new in the EEC, the Draft Insider Trading Directive represents the most authoritative step yet taken. Work on the Draft Directive dates back to the early 1980's, when the Commission organized a working party.[95] The working party researched the subject area and conferred with the member-States, members of the securities industry, and other interested professional institutions.[96] The primary reason for organizing the working party to research insider trading rests in one of the four freedoms to be achieved by the EEC as stated in the Treaty of Rome:[97] the freedom

---

[91] *Id.* at Dir. 22; Note, *supra* note 19, at 165.

[92] *See* INT'L ORG., *supra* note 5, at Dir. 22.

[93] *Id.* The Directory section of volume II.A. of *International Organization and Integration* explains these events as follows:

> 4. The final stage is that in which the Council deals with the proposal. When full agreement has been reached at the level of the Committee of P.R. [Permanent Representatives] between the Governments and the Commission, the draft-decision is placed on the Council's agenda as a so-called A-item, *i.e.* an item which requires no further discussion in the Council. The latter then confines itself to adopting the decision without debate, unless objections are raised at the meeting. Proposals on which no consensus has been reached but which are considered to be ripe for submission to the Council are termed B-items. Agreement on such points has to be reached at the political level. Debates in the Council are frequently protracted and exhausting ("marathon sessions"), particularly if they are encumbered by the combination of disparate subjects to enable member states to make concessions on certain issues in exchange for compensation in other fields ("package-deals").

Id. at Dir. 22.

[94] Note, *supra* note 19, at 165.

[95] Cruikshank, *Insider Trading in the EEC*, 10 INT'L BUS. LAW. 345, 346 (1982).

[96] *Id.*

[97] Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11.

of movement of capital.[98] The establishment of this freedom implies the establishment of a common capital market, and the Commission believes that the interpenetration of national capital markets is the best way to establish a common capital market within the Community.[99] If some national markets are less efficient than others with regard to investor protection, then the process of interpenetration is hindered. The EEC, therefore, attempted to equalize investor protection by drafting a directive on the subject.[100] After receiving the working party's recommendations and debating the issue, the Commission adopted the Draft Insider Trading Directive on April 28, 1987, and submitted it to the Council on May 25, 1987.[101]

E. Analysis of the Draft Insider Trading Directive

The text of the Draft Insider Trading Directive establishes a general prohibition of insider trading which will require West Germany to make its insider trading regulations mandatory[102] if the Draft Directive is enacted. Before setting out the prohibitive provisions of the Draft Directive, however, the Commission first addresses its justification for battling insider trading in the preamble.[103] The preamble initially recognizes that insider trading undermines investor confidence in the secondary market in transferable securities.[104] The Commission further states that because investor confidence is essential for an efficiently-operating secondary market, and since an efficiently-operating secondary market is vital to the financing of undertakings within the Community, the EEC must necessarily combat insider trading.[105] After

---

[98] Article 3(c) of the Treaty outlines the goal of obtaining the freedom of movement of capital. This article states that "the activities of the Community shall include, . . . (c) the abolition, as between member-States, of obstacles to freedom of movement for persons, service and *capital*. . . ." *Id.* at 15-16 (emphasis added).

[99] *Press Release from the Commission of the European Communities*, 4 Common Mkt. Rep. (CCH) ¶ 10,880 (Apr. 28, 1987).

[100] *Id.*

[101] *Draft Directive, supra* note 6, at preamble.

[102] The Draft Directive employs mandatory language ("Member-States shall . . .") when it addresses the responsibilities of member-States in acting to protect against insider trading. *See Draft Directive, supra* note 6 at arts. 1, 2, 3. To comply with the Draft Directive, West Germany must, therefore, make insider trading regulation mandatory.

[103] *Draft Directive, supra* note 6, at preamble.

[104] "Insider trading, by benefiting certain investors at the expense of others, is likely to undermine [the confidence of investors] and may therefore prejudice the smooth operation of the secondary market in transferable securities." *Id.*

[105] *Id.*

formulating this argument on behalf of the regulation of insider trading, the Draft Directive proceeds to describe the prohibition on insider trading. A proper examination of this prohibition necessitates breaking the prohibition down into three problem areas initially identified by the working party of the Commission: the definition of an "insider," the definition of "inside information," and the restrictions placed on insiders.[106]

The Draft Directive's definition of an "insider" is a broad, all-encompassing one, covering both primary and secondary inside traders.[107] Referring to primary inside traders, Article 1 of the Draft Directive defines an insider as "*any person* who, in the exercise of his profession or duties, acquires inside information. . . ."[108] Article 3 further extends this definition to include tippees who have "knowingly obtained inside information" from an insider as defined in Article 1 above.[109] While the definition in Article 1 is broad in scope, it is also commendably specific in setting appropriate parameters for judicial application of the definition. Clearly, words like, "in the exercise of," "profession" and "duties" must undergo judicial interpretation,[110] but overall, the definition does not appear to be

---

[106] Cruikshank, *supra* note 95, at 346.

[107] *Draft Directive, supra* note 6. The Draft Directive addresses primary insiders in Article 1 stating "any person who, in the exercise of his profession or duites, acquires inside information as defined in Article 6." *Id.* at art. 1. In Article 3 the Draft Directive goes on to define a secondary insider as "any person who has knowingly obtained inside information from a person who has acquired that information in the exercise of his profession or duties." *Id.* at art. 3.

[108] *Draft Directive, supra* note 6, at art. 1 (emphasis added). Article 1, paragraph 1 states:

> Member-States shall prohibit any person who, in the exercise of his profession or duties, acquires insider information as defined in Article 6 from taking advantage of that information to buy or sell on their territory, either directly or through another person, transferable securities admitted to trading on their stock exchange markets.

Id.

[109] *Id.* at art. 3. Article 3, paragraph 1 states that "Member-States shall impose the prohibition provided for in Article 1 in accordance with the terms referred to therein also on any person who has knowingly obtained insider information from a person who has acquired that information in the exercise of his profession or duties." *Id.*

[110] The ambiguity of these words combined with their interpretations by the separate judicial bodies of the member-States may not provide the harmony sought by the EEC. Because these words represent the paths by which one reaches the definition of an insider, the various judicial bodies may interpret these words as broadly or as narrowly as is consistent with their affinity to the idea of regulation of insider trading. The possible disparity, however, is a necessary evil if insider trading is to

plagued by any latent judicial doctrine, unlike its United States counterpart.[111]

One example of the United States courts adding a judicial doctrine to the notion of insider trading is found in the fact that while the United States anti-insider trading statute makes no express mention of a fiduciary element, the United States Supreme Court held that for a person to fall within the purview of the term insider, he must owe a fiduciary duty to the issuer, the issuer's shareholders, or another relevant third party.[112] Within the EEC's definition of insider and its corresponding prohibition, however, no apparent avenue arises by which the definition of an insider might be limited by a fiduciary element. Because the Draft Directive makes no mention of fraud, which is the basis for the incorporation of a fiduciary element into

---

be regulated on a Community-wide level. If the Draft Directive attempted to define these words, this action would merely create more words subject to judicial interpretation. In the clarification of one word, another word is created which must be interpreted. One mitigating aspect to this interpretive problem is that ultimately a case involving the interpretation of these words will come before the European Court of Justice and the court will render a single; Community-wide interpretation.

[111] The United States counterpart to the Draft Directive is § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987), issued thereunder. Section 16(b) of the Exchange Act, 15 U.S.C. § 78p(b) (1982), is limited to the disgorgement of profits realized in less than 6 months by officers, directors and beneficial owners of more than 10% of any class of any equity security from trading in their corporation's stock. While section 10(b) and Rule 10b-5, do not explicitly mention insiders or insider trading, courts interpret these sections as prohibitions against insider trading. *See, e.g.*, In Re Cady, Roberts & Co., 40 S.E.C. 907 (1961).

[112] Chiarella v. United States, 445 U.S. 222 (1980). In *Chiarella* an employee of a financial printing company traded based on information which he deduced from confidential documents concerning upcoming takeover bids which were entrusted to his employer for final printing. The United States Supreme Court held that the individual employee did not fall within the definition of an insider because he owed no fiduciary duty to the target company (whose stock he traded for a profit), nor any duty to those persons with whom he traded in the open market. The Court left open, however, the issue of whether an employee could be found to be an insider based on his fiduciary obligation to his employer or to the employer's client (the acquiring company). *Id.* at 235-36. This unresolved issue, labelled the "misappropriation" theory, has been decided in the affirmative by the Second Circuit. SEC v. Materia, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985); United States v. Newman, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir. 1983), *cert denied*, 464 U.S. 863 (1983). Recently, the United States Supreme Court tackled the issue and upheld the Second Circuit's view based on a 4 to 4 decision which holds no precedential effect. Carpenter v. United States, 108 S. Ct. 316 (1987) (there were only 8 justices due to the vacancy left by the retirement of Justice Powell).

the United States definition,[113] it appears unlikely that any fiduciary element will attach, for the definition is self-contained.

Given the standards set forth in the Draft Directive, West Germany must significantly enlarge its definition of an insider if the Council adopts the directive. As already noted, West Germany narrowly defines an insider by limiting its definition to specifically enumerated primary inside traders.[114] To comply with the Draft Directive's definition, West Germany must expand its definition to include *any* primary and *any* secondary insider trader within the scope of the directive. The United Kingdom, on the other hand, currently regulates both types of insiders,[115] so any expansion of its definition with respect to types of insiders is unnecessary. The only problem occuring with the United Kingdom definition appears with regard to the "knowingly connected" requirement associated with primary insider traders.[116] The Draft Directive contains no such restriction on defining

---

[113] *See* In re Cady, Roberts & Co., 40 S.E.C. 907 (1961) (one of the major purposes of the securities acts is the prevention of fraud, manipulation, or deceit); Chiarella v. United States, 445 U.S. 222 (1980). Section 10(b) of the Securities Exchange Act prohibits the use "in connection with the purchase or sale of any security . . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . ." 15 U.S.C. § 78j(b) (1982). Rule 10b-5 then states:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of national securities exchange,
>
> (a) To employ any device, scheme, or artifice to *defraud*,
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a *fraud* or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1987) (emphasis added). In *Chiarella*, the United States Supreme Court held that § 10(b) is a "catch-all provision" for fraud only, and that "[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak;" the Court held that "a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." Chiarella v. United States, 445 U.S. at 235. Because the United States statute mentioned "fraud," the United States Supreme Court held that there must be a fiduciary obligation. In the Draft Directive, however, there is no mention of fraud, and the duty to disclose (or refrain from trading) arises from the statute itself.

[114] *See supra* note 74 and accompanying text.

[115] *See supra* notes 52-54 and accompanying text.

[116] *See supra* note 52. Section 1(1) of the Company Securities (Insider Dealing) Act, 1985 defines a primary insider as "an individual who is or at any time in the preceding 6 months has been, *knowingly connected* with a company. . . ." Company Securities (Insider Dealing) Act, 1985, ch. 8, § 1(1) (emphasis added). Technically, because the Draft Directive does not also include the above 6 month limitation, the United Kingdom's definition must change. The situation in which this difference would be important, however, is too remote to merit attention.

primary inside traders;[117] therefore, the United Kingdom will have to remove this requirement from its definition of primary inside traders.

Similar to the definition of insider, the Draft Directive broadly defines "inside information" as:

> Information unknown to the public of a specific nature and relating to one or more issuers of transferable securities, which, if it were published, would be likely to have a material effect on the price of the transferable security or transferable securities in question.[118]

This definition, like the definition of insider, contains words vulnerable to judicial interpretation (e.g. "unknown" and "material"), but it provides a useful codification of the generally accepted meaning of inside information.[119] Four requisite elements for determining what constitutes inside information emerge from this definition, each subject to judicial interpretation. To fall within this definition, the information must be: (1) unknown to the public; (2) relating to the issuer or issuers; (3) likely to have a material effect if published; and (4) of a specific nature.

Because of the breadth with which the Draft Directive defines inside information, this definition coincides with both the United Kingdom and West German definitions.[120] Both definitions contain the first three elements of the Draft Directive's definition: unkown to the public, relating to the issuer or issuers, and likely to have a material effect if published. The fourth element of the Draft Directive's definition of inside information, that it be of a specific nature, however, is expressly mentioned only the United Kingdom's defini-

---

[117] While the Draft Directive does not restrict its definition of primary inside traders with a knowledge requirement, it does restrict secondary inside traders to "any person who has *knowingly* obtained insider information. . . ." *Draft Directive, supra* note 6, at art. 3 (emphasis added). The United Kingdom also restricts secondary inside traders in the same manner. Company Securities (Insider Dealing) Act, 1985, ch. 8, § 1(3)(a) (defining a secondary inside trader as "an individual [who] has information which he *knowingly* obtained. . . .") (emphasis added).

[118] *Draft Directive, supra* note 6, at art. 6.

[119] "Generally-accepted meaning" is not meant as a consensus of the current law of all of the member-States, but rather the consensus of those member-States currently regulating insider trading, for example the United Kingdom and West Germany.

[120] *See supra* notes 58-60, 75-77 and accompanying text. Absent a statutory definition of "inside information" in the United States, the courts have come to define it as "material, nonpublic information." *Chiarella*, 445 U.S. at 233.

Another required characteristic of inside information in the United States is "that the other [party] is entitled to know because of a fiduciary or similar relation of trust and confidence between them." *Chiarella*, 445 U.S. at 228 (quoting Restatement (Second) of Torts § 551(2)(a) (1976)).

tion.[122] This final element is non-existent in the West German definition, but would require only a slight modification for West Germany to comply with the Draft Directive.[122] With this modification as the only necessary change in either definition, the Draft Directive definition of inside information does not substantively change the law of either member-State in this area.

With the definitions of insider and inside information firmly in place, the Draft Directive then proceeds to place its restrictions upon any person or persons falling within those definitions. The Draft Directive places three restrictions on both primary and secondary insiders. The first restriction is the general prohibition against utilizing inside information to buy or sell transferable securities directly or through a broker.[123] This prohibition represents the typical insider trading restriction and is common to both the United Kingdom[124] and West Germany[125] as well as the United States.[126] One interesting limitation in the Draft Directive, however, is an express exclusion from this restriction for any transaction which takes place outside the stock exchange market and does not involve a "professional intermediary."[127] At first glance, this exception appears contrary to the Draft Directive's goal of combating insider trading; however, when viewed in light of the EEC's overall goal of promoting efficiently-operating markets and considering EEC politics in general, the exception makes sense. First, transactions external to stock exchange markets pose little threat to the smooth operation of those markets because they are not associated with the exchange markets and because their volume represents a minimal number of transactions

---

[121] *See supra* note 59 and accompanying text.

[122] While the West German definition refers generally to "known and unknown circumstances," it may be argued that this "specific nature" is nonetheless already included in the definition of inside information. This argument follows from the examples provided by the definition. Each example is of a specific nature. *See supra* notes 75 and 76 and accompanying text.

[123] *Draft Directive, supra* note 6, at arts. 1 (primary inside traders) and 3 (secondary inside traders).

[124] *See supra* notes 52-54 and accompanying text.

[125] *See supra* notes 71 and 72 and accompanying text.

[126] *See supra* notes 111-13 and accompanying text.

[127] *Draft Directive, supra* note 6, at art. 1, ¶ 2.

This exception states that "[t]he prohibition laid down in paragraph 1 shall not apply to transferable securities bought or sold outside a stock exchange market without the involvement of a professional intermediary." *Id.* The United Kingdom also has a similar provision in its 1985 Act. *See supra* notes 50 and 51 and accompanying text.

when compared to the volume carried out on the exchange markets. Second, and more important, the EEC is acting in an area where not all of the member-States are in agreement. To pass the Draft Directive it will be necessary for its proponents to compromise somewhere, and this exception may represent just such a compromise. Whatever the reason for this exception, while it poses an attractive way for insiders to circumvent this first restriction, it does not appear to be so large of a loophole as to render the Draft Directive ineffective.[128]

Two other restrictions contained in the Draft Directive are "tipper" restrictions, which are akin to the "tippee" restriction on trading but attack the problem from the opposite side. Instead of restricting the tippee (the person trading based on inside information), these provisions restrict the tipper, or the one supplying the inside information. The Draft Directive restricts tippers from disclosing inside information to another except in the ordinary course of business and further restricts the use of inside information to recommend to another the purchase or sale of transferable securities.[129] Both restrictions apply equally to primary and secondary inside traders, and are analagous to provisions contained in the United Kingdom's 1985 Act[130] and to a lesser extent in West Germany's Guidelines.[131]

---

[128] For the majority of publicly-held stocks, the benefits of trading on a recognized stock exchange outweigh the benefits of trading privately. A recognized stock exchange counters the main benefit of trading privately—circumvention of the Draft Directive—with benefits such as potentially high prices for the sale of stock (or lower prices for purchases), access to more buyers/sellers, and less risk of insider trading.

[129] *Draft Directive, supra* note 6, at arts. 2 & 3. Article 2, referring to primary insiders states:

> Member-States shall prohibit any person who is resident on their territory and who acquires inside information in the exercise of his profession or duties from:
> - disclosing that inside information to a third party unless such disclosure is made in the normal course of exercising his profession or duties,
> - using that information to recommend a third party to buy or sell transferable securities admitted to trading on their stock exchange markets.

Id. Article 3(2) directs member-States to prohibit secondary insiders from: (1) "disclosing the inside information to a third party;" and (2) "using that inside information to recommend a third party to buy or sell transferable securities admitted to trading on their stock exchange markets." *Id.*

[130] Company Securities (Insider Dealing) Act, 1985, ch. 8, §§ 1(7)-(8).

[131] *Insider Rules, supra* note 65, at § 1.1-.2; Elsing & Gasser, *supra* note 72, at 191. The authors state that insiders (which only includes tippers) are prohibited from "carrying out" or "procuring the carrying out of a transaction" based on inside information. *Id.*

Because insider trading cases frequently cross national boundaries, the Draft Directive also adopts provisions for information exchange and professional secrecy.[132] The regulating bodies of the member-States are required to freely exchange information whenever necessary,[133] thus ensuring cooperation between national authorities in investigating cases crossing national boundaries.[134] The professional secrecy provision attempts to ensure that the employees of the regulating bodies do not misuse the information gained by virtue of their position.[135]

Although the Draft Directive represents a well-drafted and positive step toward creating a true common capital market, it does not go as far as necessary to achieve harmonization. To function effectively and attain its goal, the Draft Directive must first attempt to harmonize the penalties for insider trading.[136] As seen through a comparison of the United Kingdom and West Germany, penalties for insider trading can vary widely between members. The United Kingdom imposes criminal sanctions while West Germany imposes only civil penalties based in contract, with enforcement left to the desire of the private

---

[132] *Draft Directive, supra* note 6, at arts. 8 & 9.

[133] *Id.* After mandating that member-States establish "competent authorities" for ensuring that the Draft Directive is followed, Article 8 states in paragraph 3 that "[t]he competent authorities in the member-States shall cooperate wherever necessary for the purpose of carrying out their duties and shall exchange any information for that purpose." *Id* at art. 8.

[134] *Press Release from the Commission of the European Communities*, 4 Common Mkt. Rep. (CCH) a¶a 10,880 (Apr. 28, 1987).

[135] *Draft Directive, supra* note 6, at art. 9. Article 9 provides in full:

> 1. Member-States shall provide that all persons employed or formerly employed by the competent authorities referred to in Article 8 shall be bound by professional secrecy. Information covered by professional secrecy may not be divulged to any person or authority except by virtue of provisions laid down by law.
>
> 2. Paragraph 1 shall not, however, preclude exchanges of information between the various member-States by the authorities referred to in Article 8 as provided for in this Directive. Information thus exchanged shall be covered by the obligation of professional secrecy to which the persons employed or formerly employed by the competent authorities receiving the information are subject.
>
> 3. Without prejudice to cases falling under criminal law, the authorities referred to in Article 8 which receive information may use it only for the exercise of their duties and in connection with administrative or judicial proceedings specifically relating to the exercise of those duties.

[136] *Id.* Article 11 of the Draft Directive gives to the Member-States the power to determine their own penalties for violations of the Draft Directive's provisions. *Id.* at art. 11.

party harmed; an insider will clearly prefer the punishment issued by West Germany. As long as the severity of penalties varies significantly, unified regulation of insider trading will remain a problem. Those members less desirous of regulating insider trading need only enact nominal penalties for violations, as opposed to sanctions actually deterring violations. The benefits from insider trading will thus outweigh the burden of the punishment for the activity within that member-State. At the same time, other members wishing to seriously deter insider trading will impose much harsher penalties. Any disproportionate penalties will act as a hindrance to complete interpenetration of capital markets. Unless penalties between member-States under the Draft Directive are harmonized, the problem of insider trading will only be aggravated as the stock exchange markets become truly globalized.[137]

The United Kingdom's penalties for insider trading violations of imprisonment or fine or both are the most logical sanctions to attach to the Draft Directive and most member-States will probably adopt similar penalties. The problem, however, is that one state will consider violations less grievous than others, and hence, lesser penalties will be enacted. One possible solution might be to establish, via the Draft Directive, a minimum penalty (fine or imprisonment or both) for a violation of the Draft Directive's provisions. This minimum penalty, if set at the correct level, would effectively eliminate the cost-benefit trade-off associated with insider trading transactions.

CONCLUSION

The goal of the Draft Insider Trading Directive is an important one to the proper functioning of the EEC: to provide a Community-wide minimum level of investor protection, thereby approaching a true common capital market. By prohibiting insider trading throughout the member-States, the Draft Directive accomplishes a substantial step toward this goal. The Draft Directive's provisions will require most member-States to enact legislation or supplement existing legislation, like West Germany, and even force the heavily-regulated

[137] As internationalization and interconnection of the world's stock exchange markets increase, the inefficiency of one section of that global market will pull down the efficiency of the whole global market. The problem that will occur is the same problem currently facing the EEC, but on a larger scale. By harmonizing penalties within the EEC, it will be easier for the Japanese, United States, EEC and other markets to operate smoothly in the future.

members to rethink or rephrase their legislation, as seen in the United Kingdom example. These changes, however, benefit the Community as a whole; they direct the EEC towards increased freedom of movement of capital and a true common capital market.

Notwithstanding the progress the Draft Directive represents, it falls short of attaining its goal. Because the Draft Directive makes no provision for the harmonization of penalties but in fact delegates this power to the member-States, the free flow of capital will still be inhibited. With the power to enact penalties, member-States averse to the regulation of insider trading can establish penalties too weak to deter insider trading while still complying with the Draft Directive. This practice will allow insider trading to continue in some member-States, thus inhibiting the formation of a true common capital market. Before the EEC can realistically set its sights on such a goal, it must first achieve a more comprehensive level of harmonization with regard to insider trading.

Douglas A. Nystrom